

ORIGINAL



0000034093

MEMORANDUM

30

TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGJ

DATE: October 26, 2005

RE: IN THE MATTER OF THE APPLICATION OF MATRIX TELECOM, INC. FOR A
CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD
LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES (DOCKET NO. T-
03228A-05-0244)

Attached is the Staff Report for the above referenced application. The Applicant is applying for approval to provide the following services:

- Resold Local Exchange Services

Staff is recommending approval of the application.

EGJ: AJL:tdp

Originator: Adam Lebrecht

Attachment: Original and 13 Copies

RECEIVED
2005 OCT 26 A 11:01
AZ CORP COMMISSION
DOCUMENT CONTROL

SERVICE LIST FOR: Matrix Telecom, Inc.
DOCKET NO. T-03228A-05-0244

Ms. Joan Burke
Osborn Maledon
The Phoenix Plaza
2929 North Central Avenue
Twenty-First Floor
Phoenix, Arizona 85012-2794

Mr. Ernest G. Johnson
Arizona Corporation Commission
Utilities Division
1200 West Washington
Phoenix, Arizona 85007

Mr. Christopher C. Kempley
Arizona Corporation Commission
Legal Division
1200 West Washington
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge
Arizona Corporation Commission
Hearing Division
1200 West Washington
Phoenix, Arizona 85007

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

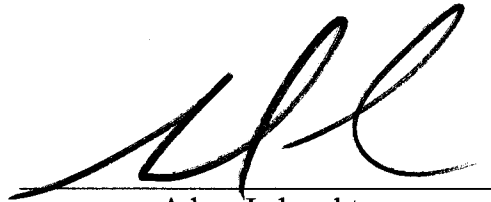
MATRIX TELECOM, INC.
DOCKET NO. T-03228A-05-0244

IN THE MATTER OF THE APPLICATION OF MATRIX TELECOM, INC. FOR A
CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD LOCAL
EXCHANGE TELECOMMUNICATIONS SERVICES

October 18, 2005

STAFF ACKNOWLEDGMENT

The Staff Report for Matrix Telecom, Inc., Docket No. T-03228A-05-0244 was the responsibility of the Staff member listed below. Adam Lebrecht was responsible for the review and analysis of the application for a Certificate of Convenience and Necessity to provide resold local exchange service and petition for a determination that its proposed services should be classified as competitive.

A handwritten signature in black ink, appearing to be 'AL', written over a horizontal line.

Adam Lebrecht
Executive Consultant I

TABLE OF CONTENTS

	PAGE
1. INTRODUCTION	1
2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES	1
3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES	1
4. ESTABLISHING RATES AND CHARGES	2
5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES	2
5.1 NUMBER PORTABILITY	2
5.2 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE.....	3
5.3 QUALITY OF SERVICE	3
5.5 911 SERVICE	4
5.6 CUSTOM LOCAL AREA SIGNALING SERVICES	4
7. COMPETITIVE SERVICES ANALYSIS	5
7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES	5
8. RECOMMENDATIONS	7
8.1 RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE	8

1. INTRODUCTION

On April 6, 2005, Matrix Telecom, Inc. ("Matrix" or "Applicant") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide resold local exchange services within the State of Arizona. The Applicant petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

Staff's review of this application addresses the overall fitness of the Applicant to receive a CC&N. Staff's analysis also considers whether the Applicant's services should be classified as competitive and if the Applicant's initial rates are just and reasonable.

2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

Matrix indicated that it currently provides local exchange service in Texas. Matrix also indicated that it has an executive Staff of 75 employees with a total combined experience of over 74 years in the telecommunications industry. Based on this, Staff believes Matrix possesses the technical capabilities to provide the services it is requesting the authority to provide.

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

The Applicant provided unaudited financial statements for the twelve months ending December 31, 2004. These financial statements list assets of \$4,393,000; negative equity of \$4,447,000; and a net income of \$1,482,000. The Applicant did not provide notes related to the financial statements.

Although the Applicant's May 10, 2005 response to Staff's first data request stated that Matrix does not collect advances, deposits and/or prepayments, Staff believes that the Applicant's customers should be protected by the procurement of a performance bond. In accordance with the Commission's current bond policy, the amount of bond coverage needed for resold local exchange is \$25,000. The bond coverage needs to increase in increments equal to 50 percent of the total minimum bond amount when the total amount of the advances, deposits, and/or prepayments is within 10 percent of the total minimum bond amount.

To that end, Staff recommends that the Applicant procure a performance bond in the amount of \$25,000. The minimum bond amount of \$25,000 should be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from the Applicant's customers. The bond amount should be increased in increments of \$12,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$2,500 of the bond amount. If the Applicant desires to discontinue service, it must file an application with the Commission pursuant to A.A.C. R14-2-1107. Additionally, 60 days prior to the filing of an application to discontinue service, the Applicant must notify each of its customers and the

Commission (through docket control) of that application prior to the filing of an application to discontinue service. Failure to meet this requirement should result in forfeiture of the Applicant's performance bond. Staff also recommends that proof of the above mentioned performance bond be docketed within 365 days of the effective date of an Order in this matter or 30 days prior to the provision of service, whichever comes first, and that the bond remain in effect until further order of the Commission.

4. ESTABLISHING RATES AND CHARGES

The Applicant would initially be providing service in areas where an incumbent local exchange carrier ("ILEC"), along with various competitive local exchange carriers ("CLECs") and interexchange carriers are providing telephone service. Therefore, the Applicant would have to compete with those providers in order to obtain subscribers to its services. The Applicant would be a new entrant and would face competition from both an incumbent provider and other competitive providers in offering service to its potential customers. Therefore, the Applicant would generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company and has determined that its fair value rate base is zero. Accordingly, the company's fair value rate base is too small to be useful in a fair value analysis. In addition, the rate to be ultimately charged by the company will be heavily influenced by the market. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to the rates of other competitive local carriers and local incumbent carriers offering service in Arizona. Matrix also indicated that these rates are identical to the rates charged in Texas and other jurisdictions in which applications to provide service are pending. Therefore, while Staff considered the fair value rate base information submitted by the company, it did not accord that information substantial weight in its analysis.

Both an actual rate and a maximum rate may be listed for each competitive service offered. The rate charged for a service may not be less than the Company's total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109.

5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES

Issues related to the provision of that Local Exchange service are discussed below.

5.1 NUMBER PORTABILITY

The Commission has adopted rules to address number portability in a competitive telecommunications services market. Local exchange competition may not be vigorous if

customers, especially business customers, must change their telephone numbers to take advantage of a competitive local exchange carrier's service offerings. Consistent with federal laws, federal rules and A.A.C. R14-2-1308(A), the Applicant shall make number portability available to facilitate the ability of a customer to switch between authorized local carriers within a given wire center without changing their telephone number and without impairment to quality, functionality, reliability or convenience of use.

5.2 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE

The Commission has adopted rules to address universal telephone service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect into the public switched network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

5.3 QUALITY OF SERVICE

Staff believes that the Applicant should be ordered to abide by the quality of service standards that were approved by the Commission for Qwest (f/k/a USWC) in Docket No. T-01051B-93-0183 (Decision No. 59421). Because the penalties developed in that docket were initiated because Qwest's level of service was not satisfactory and the Applicant does not have a similar history of service quality problems, Staff does not recommend that those penalties apply to the Applicant. In the competitive market that the Applicant wishes to enter, the Applicant generally will have no market power and will be forced to provide a satisfactory level of service or risk losing its customers. Therefore, Staff believes that it is unnecessary to subject the Applicant to those penalties at this time.

5.4 ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS

Staff expects that there will be new entrant providers of local exchange service who will install the plant necessary to provide telephone service to, for example, a residential subdivision or an industrial park much like existing local exchange companies do today. There may be areas where the Applicant installs the only local exchange service facilities. In the interest of providing competitive alternatives to the Applicant's local exchange service customers, Staff recommends that the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve such areas. This way, an alternative local exchange service provider may serve a customer if the customer so desires. Access to other providers should be provided pursuant to the provisions of the 1996 Telecommunications Act, the rules promulgated there under and Commission rules on interconnection and unbundling.

5.5 911 SERVICE

The Commission has adopted rules to address 911 and E911 services in a competitive telecommunications services market. The Applicant has certified that in accordance with A.A.C. R14-2-1201(6)(d) and Federal Communications Commission 47 CFR Sections 64.3001 and 64.3002, it will provide all customers with 911 and E911 service, where available, or will coordinate with ILECs and emergency service providers to provide 911 and E911 service.

5.6 CUSTOM LOCAL AREA SIGNALING SERVICES

Consistent with past Commission decisions, the Applicant may offer Caller ID provided that per call and line blocking, with the capability to toggle between blocking and unblocking the transmission of the telephone number, are provided as options to which customers could subscribe with no charge. Also, Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated, indicating that the number has been blocked, must be offered.

6. REVIEW OF COMPLAINT INFORMATION

The Applicant certified that it has neither had an application for service denied, nor revoked in any state. The Applicant also certified that there have been no formal or informal complaint proceedings in the other jurisdiction in which the Applicant provides service. Finally, the Applicant certified that there have not been any civil or criminal proceedings against the Applicant. Consumer Services reports no complaint history within Arizona.

The Applicant certified that none of its officers, directors or partners have been involved in any civil or criminal investigations, formal or informal complaints. The applicant also indicated that none of its officers, directors or partners have been convicted of any criminal acts in the past ten years.

Staff contacted Gordon Vansickle, a Regulatory Analyst from the Texas Public Utility Commission ("TPUC") and inquired about Matrix's complaint history in the State of Texas. Mr. Vansickle indicated that since 2003, Matrix has been the subject of five informal complaints with the TPUC. Of those five complaints, three concerned allegations of slamming, one concerned an allegation of cramming and the remaining complaint was a high bill dispute. Mr. Vansickle indicated that all the complaints were researched and closed by the TPUC without a finding of wrongdoing on the part of Matrix.

7. COMPETITIVE SERVICES ANALYSIS

The Applicant has petitioned the Commission for a determination that the services it is seeking to provide should be classified as competitive. The Applicant has indicated that by the time the hearing on this matter convenes, legal notice of the application will be published in all the counties which it is requesting the authorization to provide service. The Applicant has certified that all notification requirements will be completed. Staff's analysis and recommendations are discussed below.

7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES

7.1.1 A DESCRIPTION OF THE GENERAL ECONOMIC CONDITIONS THAT EXIST, WHICH MAKES THE RELEVANT MARKET FOR THE SERVICE ONE THAT, IS COMPETITIVE.

The local exchange market that the Applicant seeks to enter is one in which a number of new CLECs have been authorized to provide local exchange service. Nevertheless, ILECs hold a virtual monopoly in the local exchange service market. At locations where ILECs provide local exchange service, the Applicant will be entering the market as an alternative provider of local exchange service and, as such, the Applicant will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, the Applicant may have to convince developers to allow it to provide service to their developments.

7.1.2 THE NUMBER OF ALTERNATIVE PROVIDERS OF THE SERVICE.

Qwest and various independent LECs are the primary providers of local exchange service in the State. Several CLECs and local exchange resellers are also providing local exchange service.

7.1.3 THE ESTIMATED MARKET SHARE HELD BY EACH ALTERNATIVE PROVIDER OF THE SERVICE.

Since Qwest and the independent LECs are the primary providers of local exchange service in the State, they have a large share of the market. Most CLECs and local exchange resellers have a limited market share.

7.1.4 THE NAMES AND ADDRESSES OF ANY ALTERNATIVE PROVIDERS OF THE SERVICE THAT ARE ALSO AFFILIATES OF THE TELECOMMUNICATIONS APPLICANT, AS DEFINED IN A.A.C. R14-2-801.

None.

7.1.5 THE ABILITY OF ALTERNATIVE PROVIDERS TO MAKE FUNCTIONALLY EQUIVALENT OR SUBSTITUTE SERVICES READILY AVAILABLE AT COMPETITIVE RATES, TERMS AND CONDITIONS.

ILECs have the ability to offer the same services that the Applicant has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar services.

7.1.6 OTHER INDICATORS OF MARKET POWER, WHICH MAY INCLUDE GROWTH AND SHIFTS IN MARKET SHARE, EASE OF ENTRY AND EXIT, AND ANY AFFILIATION BETWEEN AND AMONG ALTERNATIVE PROVIDERS OF THE SERVICE(S).

The local exchange service market is:

- a. One in which ILECs own networks that reach nearly every residence and business in their service territories and CLECs have also entered the market:
- b. One in which new entrants will be dependent upon ILECs:
 1. To terminate traffic to customers.
 2. To provide essential local exchange service elements until the entrant's own network has been built.
 3. To interconnect.
- c. One in which ILECs have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market since new entrants do not have a long history with any customers.
- d. One in which Qwest provides a quality of service that has generated a significant number of complaints. These complaints led the Commission to adopt service quality rules that contain penalties if the service quality standards are not met. A provider of alternative service, such as the Applicant, should provide Qwest--as well as other providers--with the incentive to produce higher quality service including service installation and repair on a timely basis.
- e. One in which most customers have few, if any choices since there is generally only one or two providers of local exchange service in each service territory.
- f. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

8. RECOMMENDATIONS

Staff recommends that Matrix's application for a CC&N to provide intrastate telecommunications services, as listed in this Report, be granted. In addition, Staff further recommends:

1. That the Applicant complies with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant abides by the quality of service standards that were approved by the Commission for Qwest in Docket No. T-01051B-93-0183;
3. That the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve areas where the Applicant is the only provider of local exchange service facilities;
4. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
5. That the Applicant cooperate with Commission investigations including, but not limited to customer complaints;
6. The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company and has determined that its fair value rate base is zero. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to other competitive local carriers and local incumbent carriers offering service in Arizona. Matrix also indicated that these rates are identical to the rates charged in Texas and other jurisdictions in which applications to provide service are pending. Accordingly, the company's fair value rate base is too small to be useful in a fair value analysis. In addition, the rate to be ultimately charged by the company will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value information provided was not given substantial weight in this analysis;
7. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;
8. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated.

Staff further recommends that the Applicant be ordered to comply with the following. If it does not do so, the Applicant's CC&N shall be null and void.

1. The Applicant shall docket a conforming tariff for each service within its CC&N

within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever comes first. The tariff submitted shall coincide with the application and state that the Applicant does not collect advances, deposits and/or prepayments from its customers. The tariff submitted shall also indicate that the Applicant does not collect advances, deposits and/or prepayments.

2. The Applicant shall:

- a. procure a performance bond equal to \$25,000. The minimum bond amount of \$25,000 should be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from the Applicant's customers. The bond amount should be increased in increments of \$12,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$2,500 of the bond amount.
- b. docket proof of the performance bond within 365 days of the effective date of an Order in this matter or 30 days prior to the provision of service, whichever comes first, the performance bond must remain in effect until further order of the Commission.

8.1 RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE

Staff believes that the Applicant's proposed services should be classified as competitive. There are alternatives to the Applicant's services. The Applicant will have to convince customers to purchase its services, and the Applicant has no ability to adversely affect the local exchange or interexchange service markets. Therefore, the Applicant currently has no market power in the local exchange or interexchange service markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.

Attachment A

Preferred indicated that it is currently providing interexchange service in California and providing both long distance and local exchange service in the following states:

1. Minnesota
2. Oregon
3. Washington
4. California

Preferred indicated that it is currently providing local exchange service in the following states:

1. Minnesota
2. Oregon
3. Washington